FACTSHEET

HOW SOCIAL SECURITY IS FINANCED TO PAY BENEFITS NOW AND IN THE FUTURE

FINANCIAL MANAGEMENT OF TRUST FUNDS

The financial operations of Social Security are handled through two separate trust funds; the Federal Old-Age and Survivors Insurance Trust Fund, used to pay retirement and survivors benefits; and the Federal Disability Insurance Trust Fund, used to finance benefits for disabled workers and their families. Two Medicare trust funds—Hospital Insurance and Supplementary Medical Insurance—are used to finance the Medicare program, which is administered by the Health Care Financing Administration.

The Social Security trust funds are managed by a six-member Board of Trustees, composed of the Secretary of Treasury, the Secretary of Labor, the Secretary of Health and Human Services, the Commissioner of Social Security, and two public appointees who serve four-year terms. The Board of Trustees is required by law to report annually to the Congress on the financial condition of the funds and on estimated future operations. The report provides financial estimates for 75 years into the future. It projects how the trust funds will function under three different sets of economic and demographic assumptions ranging from pessimistic to optimistic.

HOW FINANCING WORKS

Social Security has similarities to both company pensions and insurance policies but both the financing and benefit provisions are different in important respects.

As with company pensions and private insurance companies, Social Security funds that are not used to pay benefits are not merely kept in a vault; they are invested and earnings on investments are used to help pay benefits and administrative costs. The law requires Social Security funds to be invested in U.S. government obligations bearing rates of interest similar to the long-term Treasury bonds sold to the general public. The securities earn billions of dollars in interest each year and this income currently represents nearly 10 percent of total income to the program.

Private insurance companies are considered sufficiently financed if they have reserves to cover outstanding obligations as they accrue. Social Security is considered sufficiently financed when its scheduled tax and other income will meet anticipated benefit and administrative expenses over the next 75 years. A social insurance program can rely safely on future earnings for income to pay benefits as they fall due, whereas private pensions and insurance plans (which could fail or go out of business) must maintain assets equal to all benefit amounts earned to date.

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A PIPELINE SPANNING GENERATIONS

Many think of Social Security financing in terms of a pipeline, with today's workers paying taxes at one end and yesterday's workers drawing benefits at the other. In other words, taxes paid by today's workers are used to pay benefits to today's beneficiaries. Remember, today's workers will one day be at the receiving end of the pipeline.

In the middle of the pipeline are the Social Security trust funds. These funds receive and disburse the taxes you pay. This method of financing is intended to maintain a balance between income and outgo of the program and to maintain a reserve to meet shortfalls in tax income. However, based on the Social Security amendments of 1977 and 1983, the program has been operating under a "partial reserve" method of funding. Reserve funds are now being built up to pay benefits in the future to help a smaller workforce support a larger retired population. The baby boomers, the large number of people born between 1946 and 1964, will be retiring starting around 2008. Today, there are three workers for every beneficiary; by the year 2030, there will be two workers for every beneficiary.

Based on current economic assumption, during the second decade of the next century benefit payments will exceed tax revenues and Social Security will have to redeem its trust fund reserves to meet its obligations. This means selling the securities it holds back to the government. To pay for them, the government would need to raise general taxes or sell new long-term securities in the private market. To meet the cost of the baby boom's retirement, Social Security taxes will need to be increased and/or program costs will need to be reduced.

CONCLUSION

The future of the Social Security system rests ultimately on the commitment of the American people to future generations. A number of factors indicate that the commitment will remain strong. These include the growing financial health of the system through the buildup of reserves generated by the bipartisan measures of 1983, the strong public support generated by the fact that the program touches the lives of so many people, and the strong political base represented by an aging population. The annual long-range review of the Board of Trustees and the continued scrutiny of the Congress provide an ongoing alarm system. It assures that there will always be sufficient warning to make adjustments in the system to meet the needs of future generations.